

## Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-01

INR-05 NSAE-00 RSC-01 TRSE-00 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-01 SIL-01 OMB-01 NIC-01 SS-15 NSC-05 PA-01

PRS-01 USIA-06 AGR-05 /075 W  
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R 261330Z NOV 74

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 6604

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

C O N F I D E N T I A L SECTION 1 OF 2 BRASILIA 8897

E.O. 11652: GDS

TAGS: EFIN, BR

SUBJECT: ECONOMIC TOUR D'HORIZON BY SIMONSEN AND LIRA

1. SUMMARY: THE AMBASSADOR CALLED ON FINANCE MINISTER SIMONSEN AND CENTRAL BANK PRESIDENT PAULO LIRA SEPARATELY FOR AN ECONOMIC TOUR D'HORIZON ON NOVEMBER 19 AND 21 PRIOR TO HIS DEPARTURE FOR WASHINGTON ON CONSULTATIONS. IN TWO VERY OPEN AND CANDID DISCUSSIONS, BOTH BRAZILIAN OFFICIALS GAVE A RATHER REALISTIC (IF NOT OPTIMISTIC) ASSESSMENT OF THE ECONOMIC SITUATION AND OUTLOOK. THEY INDICATED THAT THE BALANCE OF PAYMENTS WAS THE MAIN PROBLEM FACING POLICY MAKERS AND CONFIRMED THAT THE CURRENT ACCOUNT DEFICIT HAS BECOME A CONSTRAINT ON A CONTINUED RAPID RATE OF ECONOMIC GROWTH. BOTH STRESSED THE NEED TO KEEP IMPORTS DOWN NEXT YEAR AND NOTED THAT, AS A CONSEQUENCE, THE GOB IS PREPARED TO ACCEPT ANY GROWTH RATE WHICH WILL KEEP THE CURRENT ACCOUNT DEFICIT TO A "MANAGEABLE" LEVEL. SIMONSEN MENTIONED A GROWTH RATE ON THE ORDER TO 5 TO 7 PERCENT. THE AUTHORITIES WILL TRY TO KEEP IMPORTS DOWN BY FOLLOWING A TIGHT CREDIT POLICY, AND, WITH RESPECT TO IMPORTS BY PUBLIC ENTITIES, CONFIDENTIAL

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THROUGH ADMINISTRATIVE CONTROLS DESIGNED TO LIMIT THEIR

IMPORTS TO THE VERY ESSENTIALS. ON THE EXPORT SIDE, THEY WERE OPTIMISTIC OF REACHING A FIGURE IN THE \$9 TO \$9.5 BILLION RANGE. THEY ARE COOUNTING ON A GOOD YEAR FOR AGRICULTURAL EXPORTS IN ORDER TO REACH THAT GOAL. SIMONSEN CLAIMED THA THE TRADE DEFICIT IN 1975 CAN BE CUT TO \$2 BILLION (DOWN FROM THE ALMOST \$5 BILLION OF 1974). WITH RESPECT TO OFFICIAL RESERVES, SIMONSEN SAID THEY WOULD DROP BY \$1.0 BILLION BY YEAR-END (TO ABOUT \$5.4 BILLION), WHILE LIRA THOUGHT THEY MIGHT GO DOWN TO \$5.0 BILLION. (LIRA TOLD US IN CONFIDENCE THAT THE PRESENT LEVEL OF RESERVES WAS \$5.4 BILLION). A ONE-SHOT, LARGE, DEVALUATION OF THE CRUZEIRO WAS RULED OUT. BOTH OFFICIALS FELT THAT INFLATION WAS COMING RAPIDLY UNDER CONTROL AND THAT IT SHOULD NOT REALLY BE A PROBLEM IN 1975. ON THE PURELY INTERNAL ECONOMIC SIDE, THEY SEE 1975 AS AN EASIER YEAR THAN 1974. SIMONSEN PREDICTED AN INFLATION RATE OF 20 PERCENT NEXT YEAR. NEITHER OFFICIAL BELIEVED THAT THE RESULTS OF THE RECENT ELECTIONS WILL SIGNIFICANTLY AFFECT THE GOB ECONOMIC POLICIES. END SUMMARY

2. THE AMBASSADOR, ACCOMPANIED BY THE ECONOMIC COUNSELOR AND THE FINANCIAL ATTACHE, CALLED ON FINANCE MINISTER SIMONSEN AND CENTRAL BANK PRESIDENT PAULO LIRA SEPARATELY ON NOVEMBER 19 AND 21 FOR A TOUR D'HORIZON ON BRAZIL'S ECONOMIC SITUATION AND OUTLOOK PRIOR TO HIS DEPARTURE FOR WASHINGTON FOR CONSULTATIONS. FOLLOWING ARE THE HIGHLIGHTS OF THESE TWO MEETINGS:

3. BALANCE OF PAYMENTS BECOMES A CONSTRAINT ON ECONOMIC GROWTH: BOTH SIMONSEN AND LIRA CONFIRMED THAT THE BALANCE OF PAYMENTS WAS THE MAIN PROBLEM FACING POLICY MAKERS IN 1975 AND THAT THE CURRENT ACCOUNT DEFICIT HAS BECOME A CONSTRAINT ON CONTINUED HIGH RATE OF ECONOMIC GROWTH. BOTH OFFICIALS SAID THAT THE PRINCIPAL ECONOMIC POLICY OBJECTIVE IN 1975 WILL BE TO LIMIT THE CURRENT ACCOUNT DEFICIT TO A CONFIDENTIAL

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"MANAGEABLE" LEVEL. WHILE THEY DID NOT QUANTIFY WHAT IS MANAGEABLE, THEY LEFT LITTLE DOUBT THAT THERE WOULD HAVE TO BE A CONSIDERABLE DROP FROM THIS YEAR'S ESTIMATED \$7.0 BILLION DEFICIT. TO ASSURE THAT THIS OBJECTIVE IS MET, THE AUTHORITIES ARE NOT FIXING ANY GROWTH TARGET FOR NEXT YEAR AS THEY HAVE DONE IN THE PAST. ON THE CONTRARY, THEY ARE PREPARED TO ACCEPT WHATEVER GROWTH RATE IS NECESSARY

TO PREVENT THE BALANCE OF PAYMENTS FROM GETTING OUT OF HAND. SIMONSEN FIRST THOUGHT THE GROWTH RATE NEXT YEAR COULD DROP TO 5 PERCENT BUT THEN CORRECTED HIMSELF AND SAID THAT IT COULD REACH AS HIGH AS 6 TO 7 PERCENT. GIVEN THE OUTLOOK IN THE REST OF THE WORLD, IT WAS AGREED THAT THIS WOULD BE A COMMENDABLE PERFORMANCE.

4. 1974 BALANCE OF PAYMENTS RESULTS, 1975 OUTLOOK AND RESERVE LEVELS: SIMONSEN EXPECTS THE TRADE DEFICIT IN 1974 TO REACH \$5.0 BILLION (WITH IMPORTS AT \$12.4 BILLION AND EXPORTS AT \$7.4 BILLION) AND THE CURRENT ACCOUNT DEFICIT \$7.0 BILLION. HE CLAIMED THAT THE TOTAL NET CAPITAL INFLOW THIS YEAR WILL AMOUNT TO ABOUT \$6.0 BILLION SO THAT OFFICIAL RESERVES WILL ONLY HAVE TO BE DRAWN DOWN BY ABOUT \$1.0 BILLION (TO \$5.4 BILLION). LIRA'S ASSESSMENT OF THE 1974 BALANCE OF PAYMENTS SITUATION WAS ALONG SIMILAR LINES ALTHOUGH HE THOUGHT RESERVES COULD DROP DOWN TO \$5.0 BILLION. LIRA ALSO TOLD US IN CONFIDENCE THAT OFFICIAL RESERVES AT THE END OF OCTOBER WERE AT \$5.4 BILLION.

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C O N F I D E N T I A L SECTION 2 OF 2 BRASILIA 8897

5. WITH RESPECT TO 1975, BOTH SIMONSEN AND LIRA AGREED THAT IT WAS GOING TO BE A VERY DIFFICULT YEAR, BUT WERE GENERALLY OPTIMISTIC IN THEIR OVERALL ASSESSMENT. THEY BELIEVED THAT EXPORTS, PARTICULARLY OF AGRICULTURAL PRODUCTS (SUCH AS COFFEE), CAN DO CONSIDERABLY BETTER THAN THIS YEAR. BOTH FELT THAT EXPORTS IN 1975 COULD REACH THE \$9 TO \$9.5 BILLION RANGE. BOTH WERE VERY FIRM ON KEEPING IMPORTS DOWN. THEY HOPE TO ACCOMPLISH THIS PRIMARILY THROUGH A GENERAL POLICY OF TIGHT CREDIT. IN ADDITION, IMPORTS BY PUBLIC ENTITIES WOULD BE SUBJECTED TO CLOSE SCRUTINY BY AN ADMINISTRATIVE MACHINERY WHICH IS BEING SET UP FOR THIS PURPOSE. BOTH INDICATED THAT THERE WAS CONSIDERABLE STOCKPILING OF MANY IMPORTS THIS YEAR WHICH SHOULD HELP THE SITUATION NEXT YEAR. IN THIS REGARD, SIMONSEN APPEARED TO BE SOMEWHAT MORE OPTIMISTIC THAN LIRA. SIMONSEN CLAIMED THAT THERE CAN BE A \$1.0 BILLION DROP IN IMPORTS IN 1975 (TO \$11.0/\$11.5 BILLION), WHILE LIRA IMPLIED THAT AN IMPORT LEVEL EQUAL TO 1974 WOULD BE SATISFACTORY. SIMONSEN BELIEVED THAT THE TRADE DEFICIT COULD BE KEPT TO \$2 BILLION NEXT YEAR. LIRA WAS SKEPTICAL ABOUT THE

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POSSIBILITY OF GETTING SIGNIFICANT AMOUNTS OF ARAB MONEY OVER THE SHORT RUN.

6. INFLATION: SIMONSEN AND LIRA WERE CONFIDENT THAT INFLATION IS RAPIDLY COMING UNDER CONTROL AND THAT IT WOULD NOT BE A PROBLEM NEXT YEAR. LIRA SAID THAT THE EXCESS LIQUIDITY CAUSED BY THE EXPANSIONARY MONETARY POLICY OF 1973 HAD BEEN ELIMINATED AND THAT BY YEAR-END THE GROWTH OF REAL LIQUIDITY WOULD BE IN LINE WITH THE ECONOMY'S UNDERLYING GROWTH. SIMONSEN NOTED THAT THE GROWTH OF THE MONEY SUPPLY IN 1974 WOULD PROBABLY BE BELOW THE 35 PERCENT CEILING SET IN THE MONETARY BUDGET. HE THOUGHT INFLATION IN 1975 WOULD BE ABOUT 20 PERCENT.

7. RECENT ECONOMIC MEASURES: WHEN ASKED ABOUT THE SIGNIFICANCE OF THE RECENT ECONOMIC MEASURES ON THE CREDIT AND WAGE FRONTS (SEE BRASILIA 8159). LIRA DENIED BOTH THE FACT THAT THEY SIGNALLED A SHIFT IN ECONOMIC POLICY AND THAT THE AUTHORITIES WERE EMBARKING ON A REFLATIONARY PATH, IGNORING THE CONSTRAINT IMPOSED BY THE BALANCE OF PAYMENTS. HE SAID THESE STEPS WERE THE NORMAL FOLLOW-ON OF THE VERY AUSTERE CREDIT MEASURES FOLLOWED EVER SINCE THE NEW GOVERNMENT CAME TO POWER IN MARCH AND WHICH RESULTED IN A REAL CRUNCH DURING SEPTEMBER/OCTOBER. THE WAGE "ABONO" WAS NECESSARY, HE SAID, TO COMPENSATE

WORKERS FOR THE INCREASE IN THE COST OF LIVING WHICH EXCEEDED THE INFLATION FACTOR CALCULATED IN THE WAGE FORMULA EARLIER THIS YEAR. SINCE THIS AMOUNTS TO AN ADVANCE OF NEXT YEAR'S WAGE INCREASE, IT REDUCES THE INFLATIONARY PRESSURES OF WAGES IN 1975. LIRA ACKNOWLEDGED THAT THE MONETARY CORRECTION MECHANISM WORKS MOST EFFECTIVELY ON THE DOWNWARD PHASE OF THE INFLATION CYCLE. WHEN INFLATION IS GOING UP FROM YEAR TO YEAR, AS IS THE CASE IN 1974, THE MONETARY CORRECTION MECHANISM USED BY BRAZIL CAUSES DIFFICULTIES. THE RECENT MEASURES WERE DESIGNED, IN PART, TO GET AROUND THIS PROBLEM.

8. DEVALUATIONS: BOTH SIMONSEN AND LIRA STRESSED THAT THE POLICY OF MINI-DEVALUATIONS WAS NOT BEING CONFIDENTIAL

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ABANDONED. THEY HAD BEEN AWARE OF THE RECENT RUMORS CIRCULATING IN THE RIO AND SAO PAULO BANKING AND BUSINESS COMMUNITIES ABOUT THE POSSIBILITY OF A ONE-SHOT, LARGE, DEVALUATION. THE LATEST MINI-DEVALUATION, ANNOUNCED AT THE TIME THESE RUMORS WERE AT A PEAK, WAS DESIGNED TO DEMONSTRATE THAT THE AUTHORITIES WERE STANDING FIRM. BOTH SAID THAT A BIG DEVALUATION IS NOT JUSTIFIED, GIVEN BRAZIL'S EXPORT PERFORMANCE OF RECENT YEARS. IN ADDITION, SUCH A MOVE WOULD CALL INTO QUESTION THE CRAWLING PEG SYSTEM WHICH, THEY BELIEVE, HAS BEEN OPERATING RATHER EFFECTIVELY.

9. IMPACT OF ELECTIONS ON ECONOMIC POLICY: WHEN ASKED TO ASSESS THE LIKELY IMPACT, IF ANY, OF THE RECENT ELECTIONS ON ECONOMIC POLICY, BOTH OFFICIALS REPLIED RATHER FIRMLY THAT THEY DID NOT SEE ECONOMIC POLICIES BEING REFURBISHED BECAUSE OF THE ELECTION RESULTS. WHEN ASKED SPECIFICALLY BY THE AMBASSADOR WHETHER POLICY MAKERS WOULD BE ABLE TO INSULATE THEMSELVES FROM THE OPPOSITION RHETORIC, SIMONSEN SAID THAT THE EXECUTIVE STILL HOLDS ABSOLUTE CONTROL OVER THE FORMULATION OF MONETARY AND FISCAL POLICIES THROUGH THE MECHANISMS OF THE MONETARY COUNCIL AND THE POWERS OF PRESIDENTIAL DECREES. BOTH SIMONSEN AND LIRA WERE OPTIMISTIC THAT THEY CAN CONTINUE TO PURSUE THE POLICIES ASSOCIATED WITH THE SO-CALLED BRAZILIAN ECONOMIC MODEL, ALTHOUGH THEY CONCLUDED THAT, WITH A STRONGER OPPOSITION PARTY, THERE MAY BE GREATER DISCUSSIONS ABOUT THE MERITS OF THIS MODEL (I.E., THE RELIANCE ON FOREIGN INVESTMENTS, THE ROLE OF THE MULTINATIONALS, THE EXPORT DRIVE, ETC.).  
JOHNSON

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